

**HEARTLAND INSURANCE  
RISK POOL**

**JUNE 30, 2013**

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**HEARTLAND INSURANCE RISK POOL**

FINANCIAL STATEMENTS  
with  
INDEPENDENT AUDITORS' REPORT

YEARS ENDED JUNE 30, 2013 AND 2012

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# CONTENTS

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## Financial Statements

	Page
Independent auditors' report	1
Statutory statements of admitted assets, liabilities, and surplus	3
Statutory statements of income and surplus	4
Statutory statements of cash flows	5
Notes to statutory financial statements	6

## INDEPENDENT AUDITORS' REPORT

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Board of Trustees  
Heartland Insurance Risk Pool  
Tama, Iowa

We have audited the accompanying statutory statements of admitted assets, liabilities, and surplus of Heartland Insurance Risk Pool (the "Pool") as of June 30, 2013 and 2012, and the related statutory statements of income and surplus and cash flows for the years then ended. These statutory financial statements are the responsibility of the Pool's management. Our responsibility is to express an opinion on these statutory financial statements based on our audits.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of the Iowa Department of Commerce, Insurance Division. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### **Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles**

As described in Note 2, the financial statements are prepared by the Pool on the basis of the financial reporting provisions of the Iowa Department of Commerce, Insurance Division, which is a basis of accounting other than U.S. generally accepted accounting principles, to comply with the requirements of the Iowa Department of Commerce, Insurance Division. The effects on the financial statements of the variances between the statutory basis of accounting described in Note 2 and U.S. generally accepted accounting principles, although not reasonably determined, are presumed to be material.

### **Adverse Opinion on U.S. Generally Accepted Accounting Principles**

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with U.S. generally accepted accounting principles, the financial position of the Pool as of June 30, 2013 and 2012, or the results of its operations or its cash flows for the years then ended.

### **Opinion on Regulatory Basis of Accounting**

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of the Pool as of June 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, on the basis of the financial reporting provisions of the Iowa Department of Commerce, Insurance Division, as described in Note 2.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 8, 2013 on our consideration of the Pool's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Pool's internal control over financial reporting and compliance.

*Conner Ash P.C.*

St. Louis, Missouri  
October 8, 2013

# HEARTLAND INSURANCE RISK POOL

## STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES, AND SURPLUS

	June 30,	2013	2012
<b>ADMITTED ASSETS</b>			
Investments		\$ 6,490,855	\$ 5,666,457
Cash		879,933	1,745,640
Total cash and investments		7,370,788	7,412,097
Premium receivable		-	3,754
		<u>\$ 7,370,788</u>	<u>\$ 7,415,851</u>
<b>LIABILITIES AND SURPLUS</b>			
<b>LIABILITIES</b>			
Reserve for losses and loss adjustment expenses (notes 4 and 5)		\$ 2,640,000	\$ 2,560,000
Other liabilities		31,197	32,709
<b>TOTAL LIABILITIES</b>		<b>2,671,197</b>	<b>2,592,709</b>
<b>SURPLUS</b>		<b>4,699,591</b>	<b>4,823,142</b>
		<u>\$ 7,370,788</u>	<u>\$ 7,415,851</u>

See accompanying notes and accountants' report.

# HEARTLAND INSURANCE RISK POOL

## STATUTORY STATEMENTS OF INCOME AND SURPLUS

Years Ended June 30,	2013	2012
<b>UNDERWRITING OPERATIONS</b> (notes 2, 3, and 4):		
Premiums earned, net of reinsurance	<u>\$ 2,185,029</u>	<u>\$ 1,343,452</u>
Losses and loss expenses incurred, net of reinsurance	<u>1,928,188</u>	<u>2,540,453</u>
Underwriting expenses	<u>485,092</u>	<u>393,458</u>
	<u>2,413,280</u>	<u>2,933,911</u>
<b>NET UNDERWRITING LOSS</b>	<b>(228,251)</b>	<b>(1,590,459)</b>
<b>MISCELLANEOUS INCOME</b>	-	29,278
<b>INVESTMENT INCOME</b>	<u>104,700</u>	<u>108,391</u>
<b>NET LOSS</b>	<b>(123,551)</b>	<b>(1,452,790)</b>
<b>SURPLUS at beginning of year</b>	<u>4,823,142</u>	<u>6,275,932</u>
<b>SURPLUS at end of year</b>	<u><u>\$ 4,699,591</u></u>	<u><u>\$ 4,823,142</u></u>

See accompanying notes and accountants' report.

# HEARTLAND INSURANCE RISK POOL

## STATUTORY STATEMENTS OF CASH FLOWS

Years Ended June 30,	2013	2012
<b>CASH FROM OPERATIONS</b>		
Net premiums collected	\$ 2,188,783	\$ 1,339,698
Net losses and loss adjustment expenses paid	(1,848,188)	(2,030,453)
Underwriting expenses paid	(486,604)	(386,620)
Cash used in operations	(146,009)	(1,077,375)
Miscellaneous income received	-	29,278
Net investment income received	104,700	108,391
<b>Net cash used in operations</b>	<b>(41,309)</b>	<b>(939,706)</b>
<b>CASH FROM INVESTMENTS</b>		
Proceeds from investments sold or matured	1,813,130	1,538,645
Cost of investments acquired	(2,637,528)	(1,338,750)
<b>Net cash provided by investing activities</b>	<b>(824,398)</b>	<b>199,895</b>
<b>NET CHANGE IN CASH</b>	<b>(865,707)</b>	<b>(739,811)</b>
<b>CASH AT BEGINNING OF YEAR</b>	<b>1,745,640</b>	<b>2,485,451</b>
<b>CASH AT END OF YEAR</b>	<b>\$ 879,933</b>	<b>\$ 1,745,640</b>

See accompanying notes and accountants' report.



# HEARTLAND INSURANCE RISK POOL

## NOTES TO STATUTORY FINANCIAL STATEMENTS

June 30, 2013 and 2012

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### 1. HISTORY AND BUSINESS ACTIVITY

Heartland Insurance Risk Pool (the "Pool") operates as a self-insured risk pool. The Pool was formed July 1, 1987 and provides insurance coverage to ten rural counties in Iowa.

The Pool self-insures workers' compensation, automobile liability, automobile physical damage, crime, and property lines of business on an occurrence basis. General liability, law enforcement, and public official errors and omissions coverage is written on a claims-made basis.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of presentation

The Pool prepares its statutory financial statements in conformity with accounting practices prescribed or permitted by the Iowa Department of Commerce, Insurance Division. The statutory accounting financial statements are in accordance with the National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual*, subject to any deviations prescribed or permitted by the State of Iowa insurance commissioner. The Pool is currently applying only prescribed accounting practices. Statutory accounting practices, in accordance with NAIC *Accounting Practices and Procedures Manual*, vary in some respects from accounting principles generally accepted in the United States of America (GAAP) and include the following differences: (1) reinsurance recoverables on unpaid losses are netted rather than presented gross; (2) the statutory financial statements do not include a statement of comprehensive income; and (3) the statement of cash flows does not include classifications consistent with GAAP, and a reconciliation of net income to net cash provided by operating activities is not provided.

#### Use of estimates

The preparation of statutory financial statements in conformity with accounting practices prescribed or permitted by the Iowa Department of Commerce, Insurance Division, requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Cash

The Pool maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Pool has not experienced any losses on such accounts. The Pool believes it is not exposed to any significant credit risk on cash.

**See accountants' report.**

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

### Valuation of investments

Investments are comprised of certificates of deposit with varying maturities and are carried at cost, which approximates fair value. The cost of securities sold is based upon the specific identification method. Maturities were as follows at June 30:

	2013	2012
Less than one year	\$2,609,046	\$3,088,326
One to five years	3,881,809	2,578,131
	<u>\$6,490,855</u>	<u>\$5,666,457</u>

### Premium income recognition

All policies have a twelve-month term and expire on June 30. As a result, all premiums are earned by the June 30 year-end and are reported net of applicable reinsurance.

### Reserve for losses and loss adjustment expenses

The Pool provides liabilities for losses based upon undiscounted aggregate case basis estimates for losses reported; estimates of unreported losses based upon past experience, modified for current trends; and deductions of amounts for reinsurance placed with reinsurers. Losses are reported net of amounts recoverable from salvage and subrogation.

### Income taxes

The Pool was formed under Chapter 28E of the Iowa Code and is tax-exempt under Section 115 of the Internal Revenue Code.

## 3. SERVICE AGREEMENTS

The Pool has agreements with Risk Management Solutions of Iowa, Inc., and Arthur J. Gallagher & Co. to act as a service agent for the self-insured lines of business and provide administrative, brokerage and loss control services. In May 2011, The Pool entered into an agreement with Thomas McGee to provide claims services. Prior to May 2011, Alternative Risk Services, LLC provided claims services. As of July 1, 2012, the Pool entered into an agreement with Creative Risk Solutions to provide claims services. The service fees for the years ended June 30, 2013 and 2012 were as follows:

	2013	2012
Claims services	\$159,500	\$106,500
Administrative services	116,628	113,778
Brokerage services	75,000	75,000
Loss control services	76,258	36,632
	<u>\$427,386</u>	<u>\$331,910</u>

See accountants' report.

#### 4. REINSURANCE

The Pool cedes insurance to other insurers in order to limit its maximum loss through risk diversification. Insurance ceded by the Pool does not relieve its primary liability as the originating insurer. The amounts deducted for reinsurance ceded were as follows:

	Direct	Ceded	Net
2013:			
Premiums written and earned	\$3,204,979	\$1,016,195	\$2,188,784
Losses and loss adjustment expenses incurred	\$2,158,751	\$ 230,563	\$1,928,188
Reserve for losses and loss adjustment expenses	\$3,133,850	\$ 493,850	\$2,640,000
2012:			
Premiums written and earned	\$2,079,505	\$ 967,564	\$1,111,941
Losses and loss adjustment expenses incurred	\$1,699,515	\$ 534,267	\$1,165,248
Reserve for losses and loss adjustment expenses	\$2,612,569	\$ 562,569	\$2,050,000

The basic ceded reinsurance treaties benefiting the Pool apply to risks on an excess basis. The base per occurrence retention levels of the Pool are as follows:

Policy period ended	Workers' compensation	Auto, law enforcement, public official and general liability	Property
Through June 30, 2002	\$350,000	\$250,000	\$ 50,000
June 30, 2003	\$350,000	\$350,000	\$100,000
June 30, 2004	\$500,000	\$350,000	\$100,000
June 30, 2005 - 2013	\$750,000	\$400,000	\$100,000

The Pool does not have aggregate reinsurance for periods after June 30, 2002. The workers' compensation reinsurance policy periods ending June 30, 2013 and 2012 have \$250,000 corridors; this means that the Pool must pay an additional \$250,000 on its first loss exceeding the retention level before the reinsurer becomes liable.

See accountants' report.

## 5. RESERVE FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

Activity in reserve for losses and loss adjustment expenses is summarized as follows:

	2013	2012
Balance as of July 1, net of reinsurance recoverable of \$906,742 in 2012 and \$562,569 in 2011.	<b>\$2,560,000</b>	\$2,050,000
Incurred related to:		
Current year	<b>1,654,895</b>	1,799,695
Prior years	<b>273,293</b>	740,758
Total incurred	<b>1,928,188</b>	2,540,453
Paid related to:		
Current year	<b>1,091,010</b>	676,912
Prior years	<b>757,178</b>	1,353,541
Total paid	<b>1,848,188</b>	2,030,453
Balance as of June 30, net of reinsurance recoverable of \$493,850 in 2013 and \$906,742 in 2012	<b>\$2,640,000</b>	\$2,560,000

The reserving process relies on the basic assumption that past experience, adjusted for the effect of current developments and likely trends, is an appropriate basis for predicting future events. Reserve amounts are necessary based on management's informed estimates. As other data becomes available and is reviewed, these estimates and judgments are revised, resulting in increases and decreases to existing reserves. As a result of changes in estimates of ultimate losses on insured occurrences in prior years, the Pool had unfavorable development of \$273,293 in 2013 and unfavorable development of \$740,758 for 2012. Development for losses and loss adjustment expenses on prior years can vary significantly due to the small size of the Pool. As of June 30, 2013, the Pool expects reinsurance recoveries of \$493,850 from General Reinsurance Corporation.

## 6. CONTINGENCIES

The Pool is subject to lawsuits arising in the normal course of the insurance business. The Pool believes that the resolution of these lawsuits will not have a material adverse effect on its financial condition or its results of operations. The Pool has reserves which are believed adequate to cover any potential liabilities arising out of all such pending or threatened proceedings.

## 7. SUBSEQUENT EVENTS

Management has evaluated subsequent events through October 8, 2013, the date on which the financial statements were available to be issued.

**See accountants' report.**